Development of Modern Pay & HR Practices

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Anderson & Public Policy

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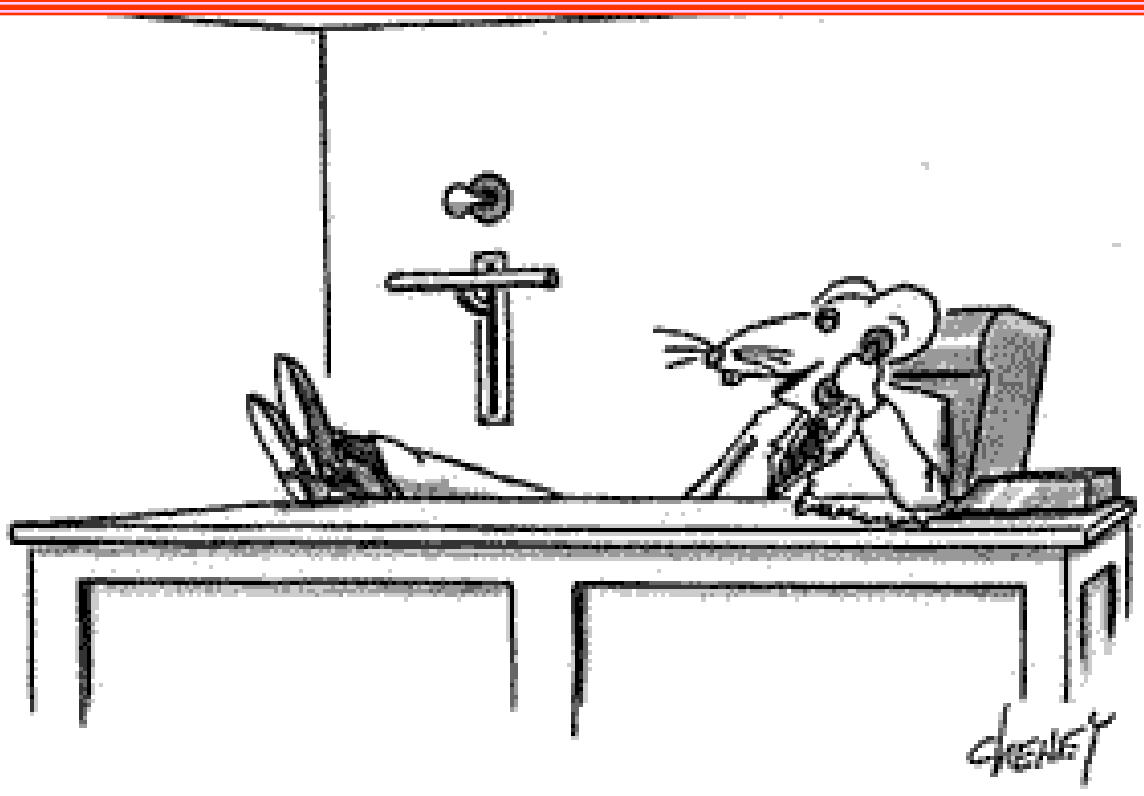

"Oh, not bad. The light comes on, I press the bar, they write me a check. How about you?"

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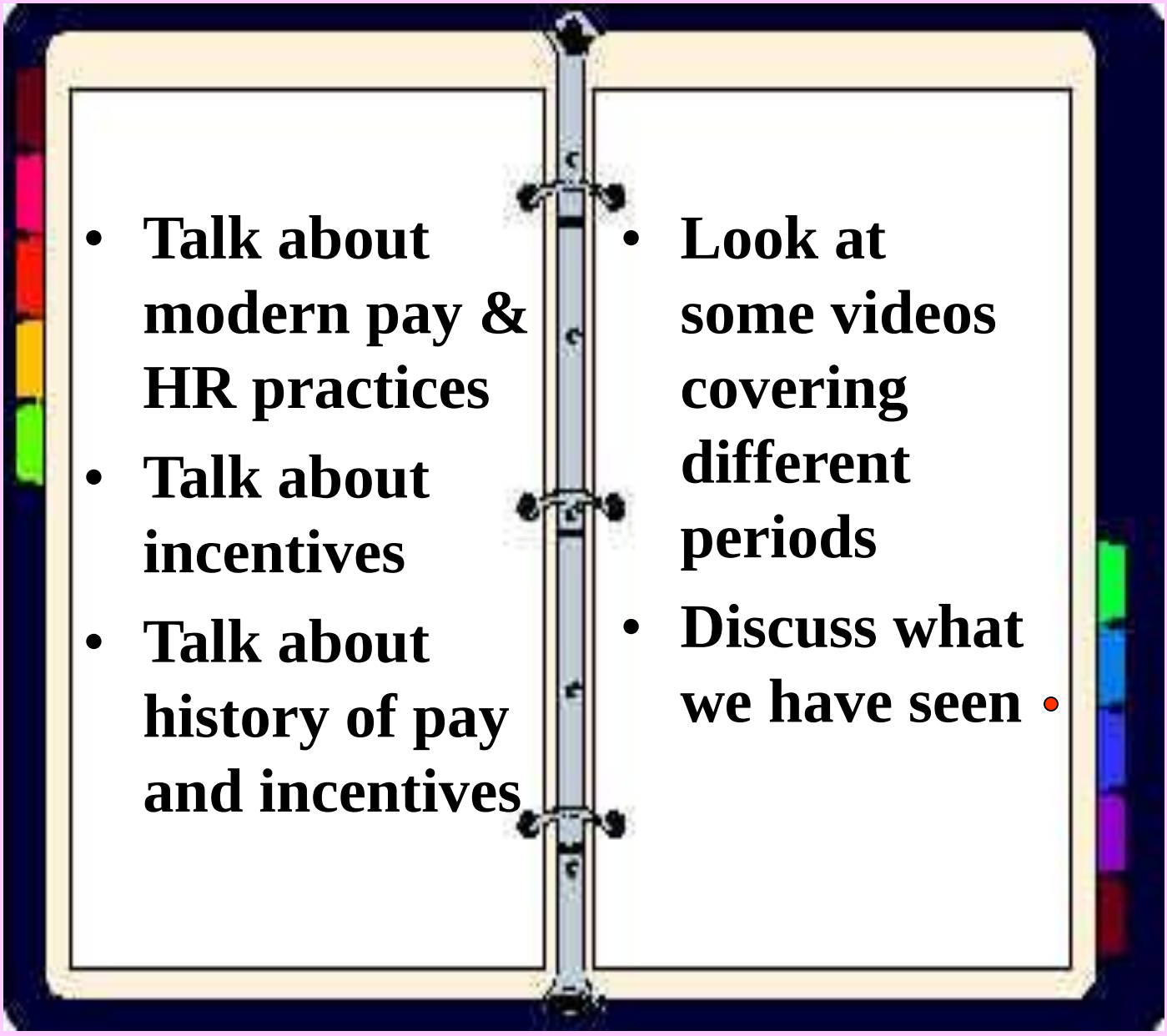
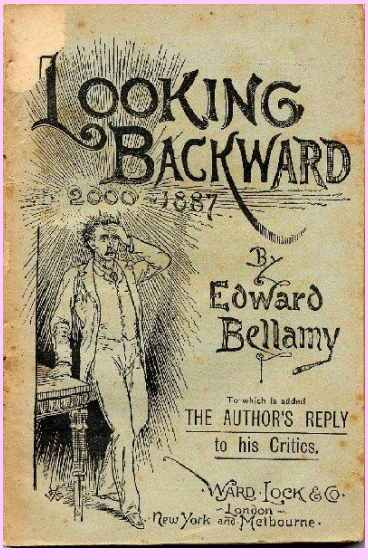
Today's Agenda



- **Talk about modern pay & HR practices**
- **Talk about incentives**
- **Talk about history of pay and incentives**
- **Look at some videos covering different periods**
- **Discuss what we have seen**

"You ask me how we regulate wages; I can only reply that there is no idea in the modern social economy which at all corresponds with what was meant by wages in your day."



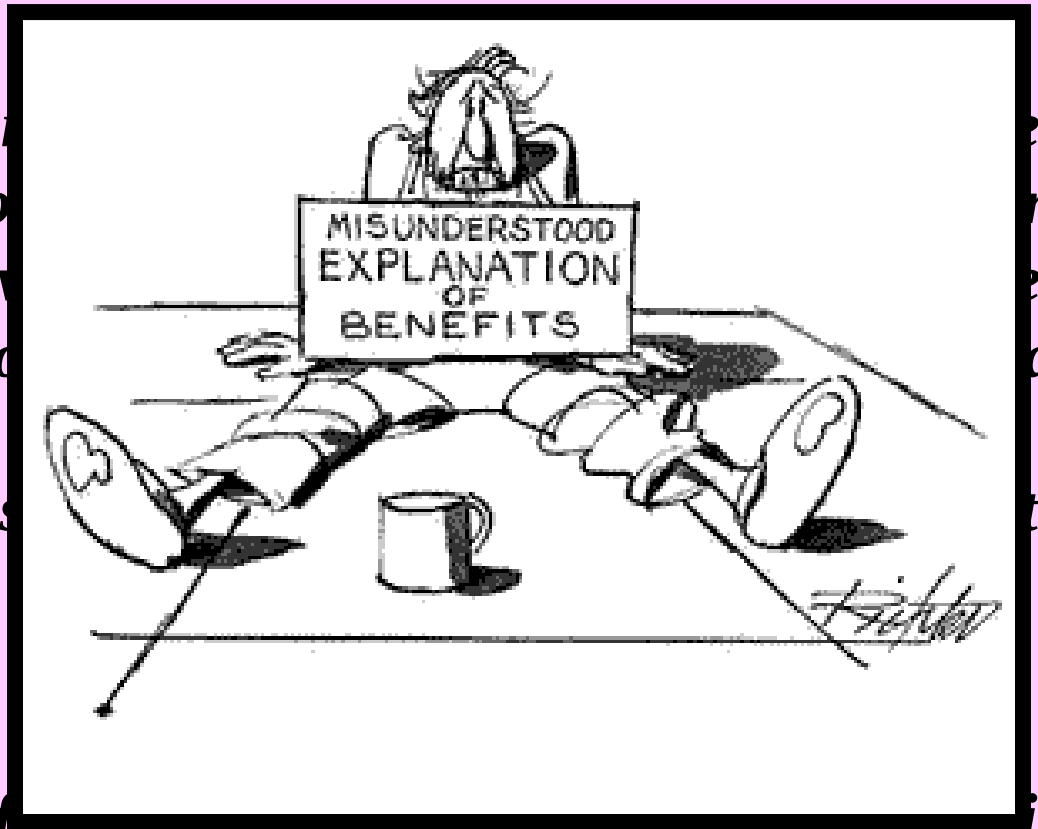
Edward Bellamy writing in 1887 in the novel *Looking Backwards* about a utopia in the year 2000

Bradbury Building, 1893

"Under the present accounting standards, where surrendered shares are not 'mature,' the stock swap will be considered the functional equivalent of the cash settlement of a stock appreciation right, resulting in variable plan accounting treatment (the compensation expense will be estimated at the time of grant and adjusted in each subsequent accounting period to reflect changes in the fair market value of the company's stock) and ultimately the recognition of an expense equal to the difference between the option exercise price and the fair market value of the company's stock on the date of exercise."

"The Stock Options Book," 3rd ed., NCEO, 1999

"Under the present accounting standards, where surrendered shares are not 'mature,'



difference between the option exercise price and the fair market value of the company's stock on the date of exercise."

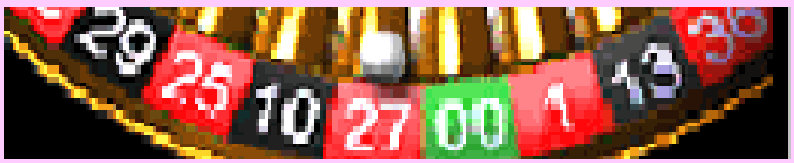
"The Stock Options Book," 3rd ed., NCEO, 1999

Defining Compensation

- **Time-based wages**
  - *Level*
  - *Structure*

- **Social welfare benefits**
  - *Pensions, health insurance*
  - *Publicly-provided or mandated benefits*

- **Individual and small group incentives**
- **Risk sharing plans**



Social Welfare Benefits

- **Pensions, health insurance, etc.**
- **Often tax incentives**
- **Rigid in sense that do not vary with performance**
- **Can have anti-mobility effects**
  - ***"Job lock" with regard to health care and pre-existing ailments***
  - ***"Golden handcuffs" of defined-benefit pensions***

“There are no medical or pension benefits, but the employees’ lounge has excellent free coffee.”

Individual and Small Group Incentives

- **Piece rates**
  - *No incentive for cooperation*
  - *Can promote waste*
  - *Employees can distort*

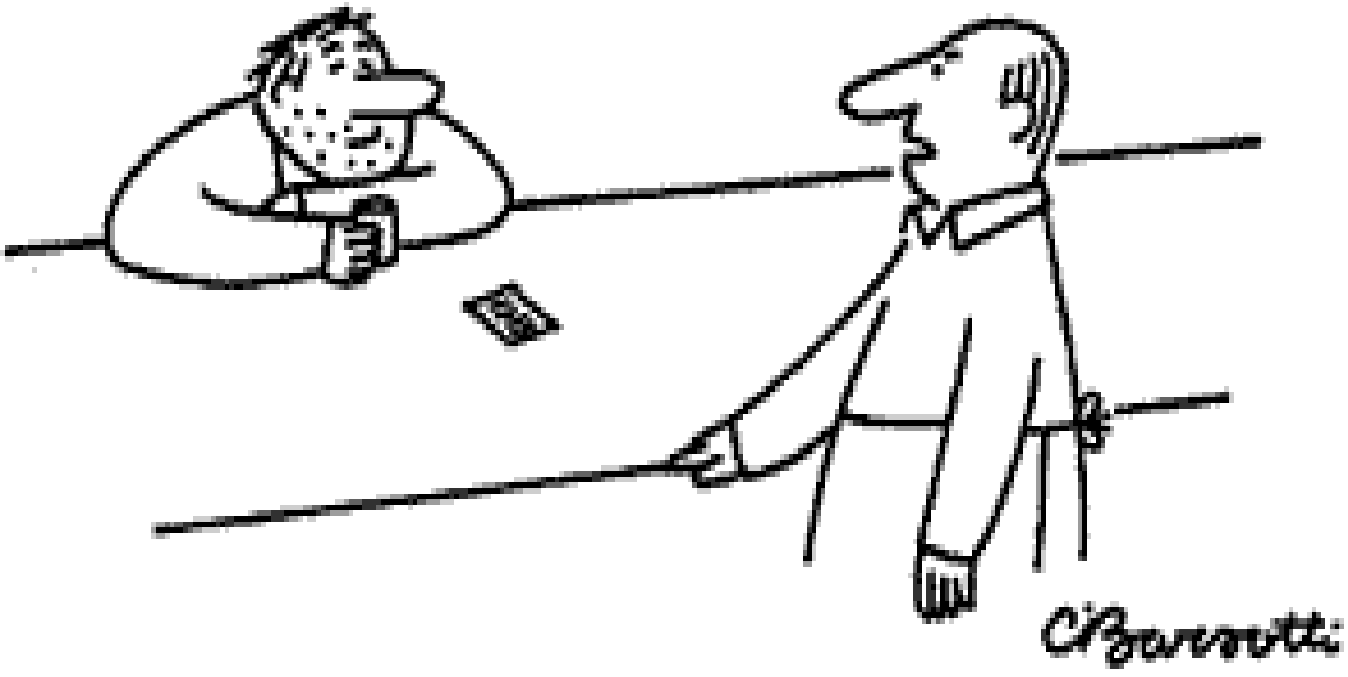
- **Elaborate "scientific management" systems**
- **Subjective systems such as merit bonuses based on performance appraisals**

"In my view, management overrates the motivational appeal of mackeral."

- *Incentive Design Problems?*
- *Other Motivators?*

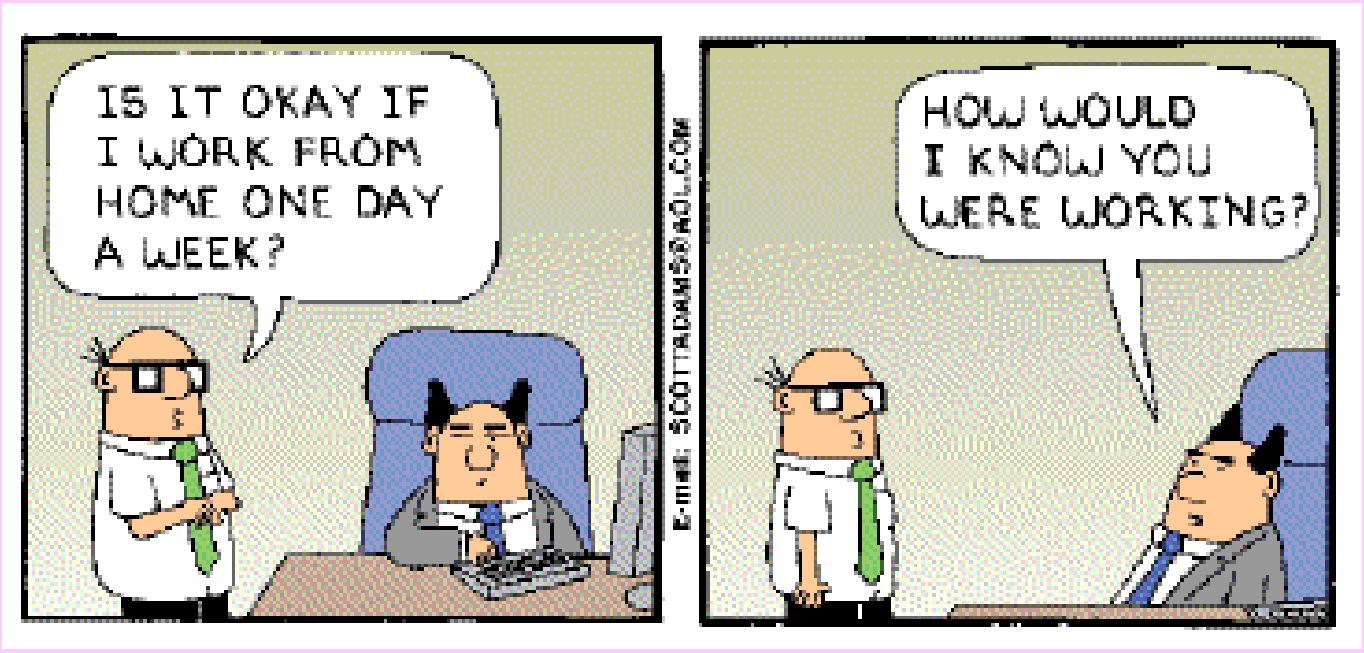
Risk Sharing Plans

- **Profit sharing**
- **Gain sharing**
- **Employee stock ownership plans (ESOPs)**
- **Other forms of share ownership**
- **Stock options**
- **Issue: Classic 1/N problem if seen as incentive (a.k.a. “free rider” problem)**



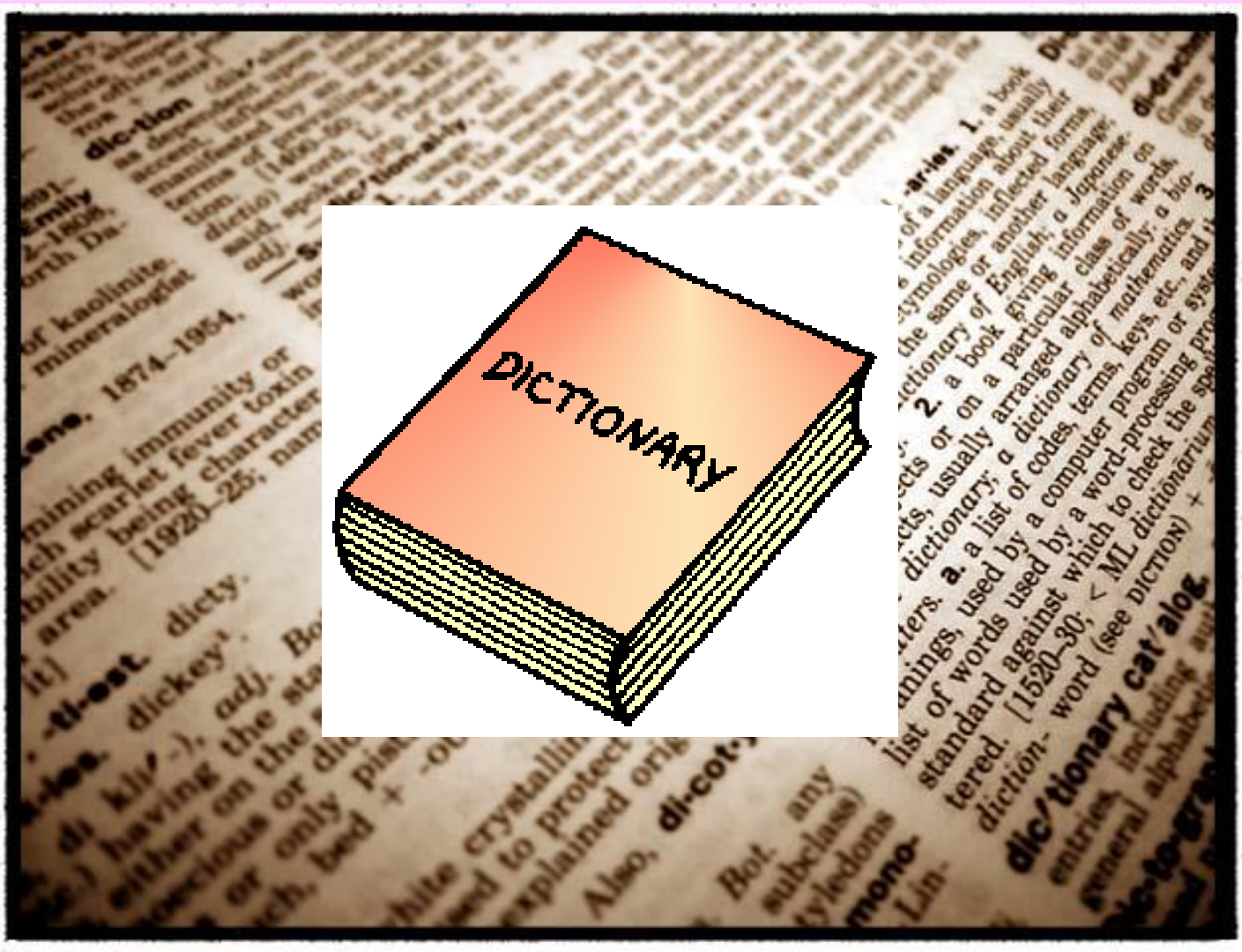
"I don't want stock options. I want you to pay your tab."

Incentive fads come and go



Principal/agent problem

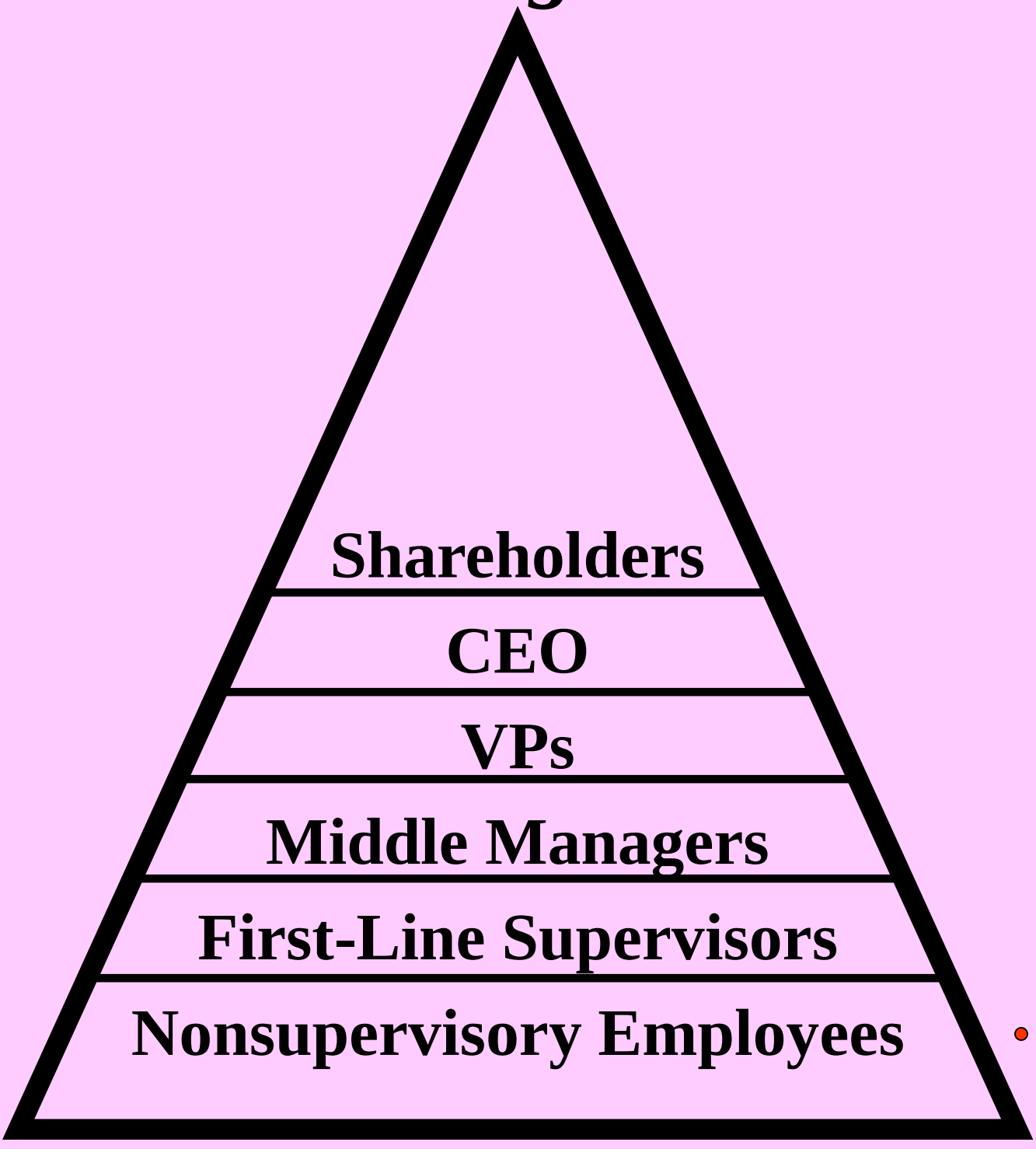
What does the word *“decimate”* mean?



What does the word *"decimate"* mean?

"Decimate" originally referred to the killing of every tenth person, a punishment used in the Roman army for mutinous legions.

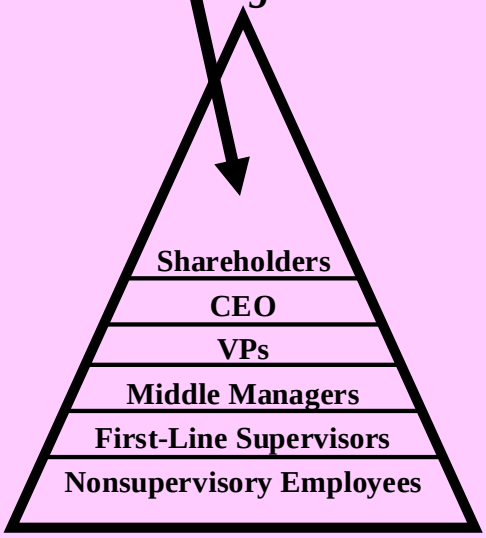
Hierarchy of Principals and Agents



Board Chair Kenneth Lay

CEO Jeff Skilling

Hierarchy of Principals and Agents



CFO Andrew Fastow

Skilling's mom on the principal/agent problem

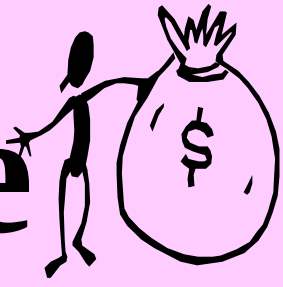
"When you are the CEO and are on the Board of Directors, you are supposed to know what's going on with the rest of the company."

---Betty Skilling

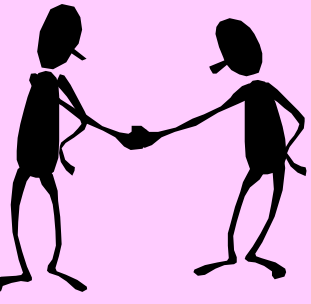
Mother knows best

How Do You Get the Help to Do What You Want?

- **Compensate**

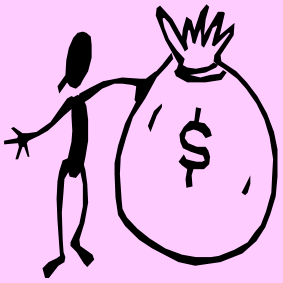


- **Motivate**

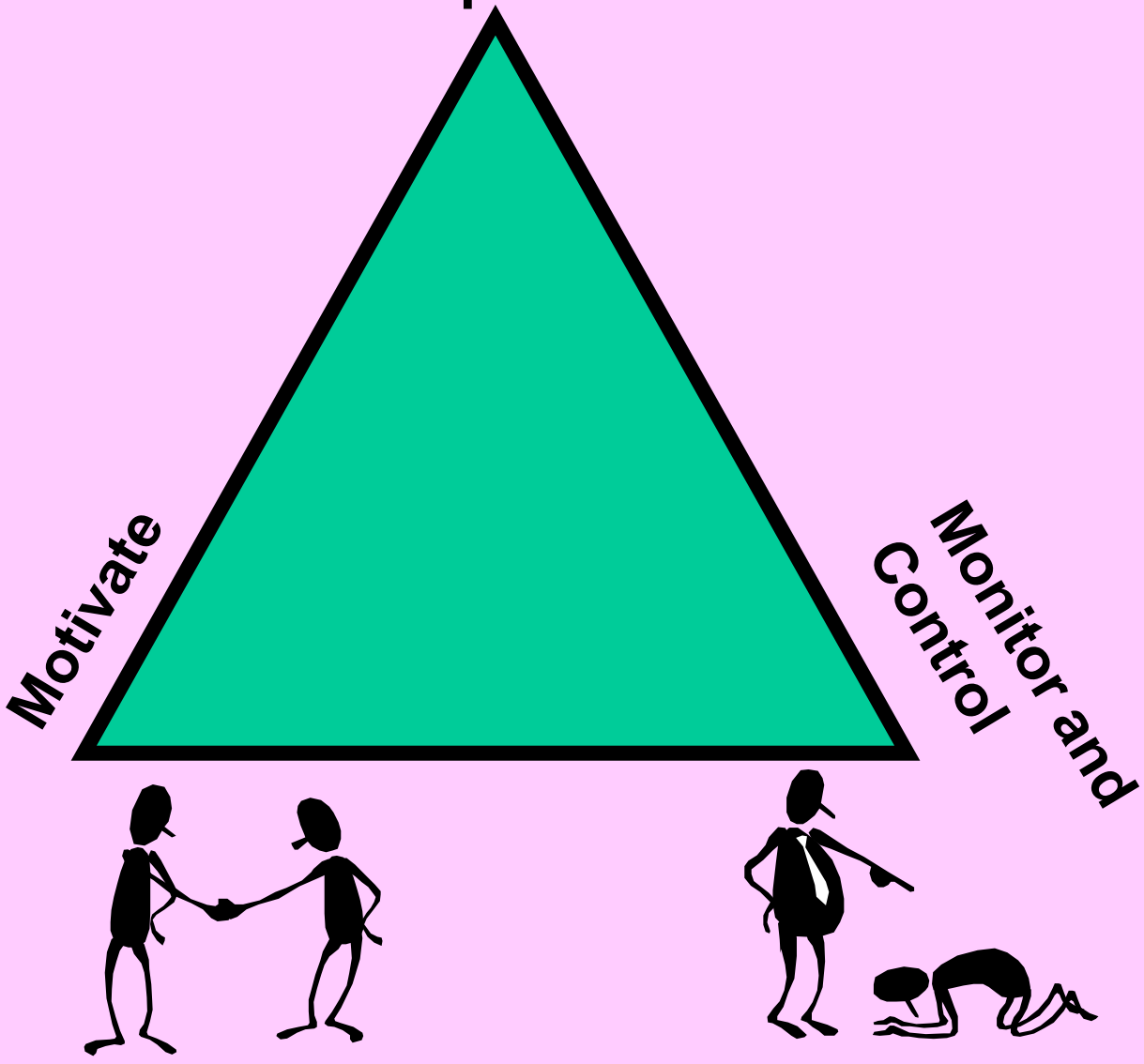


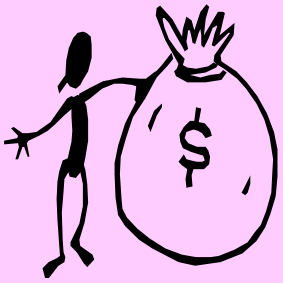
- **Monitor and Control**

Where Does the Enterprise End Up?



Compensate

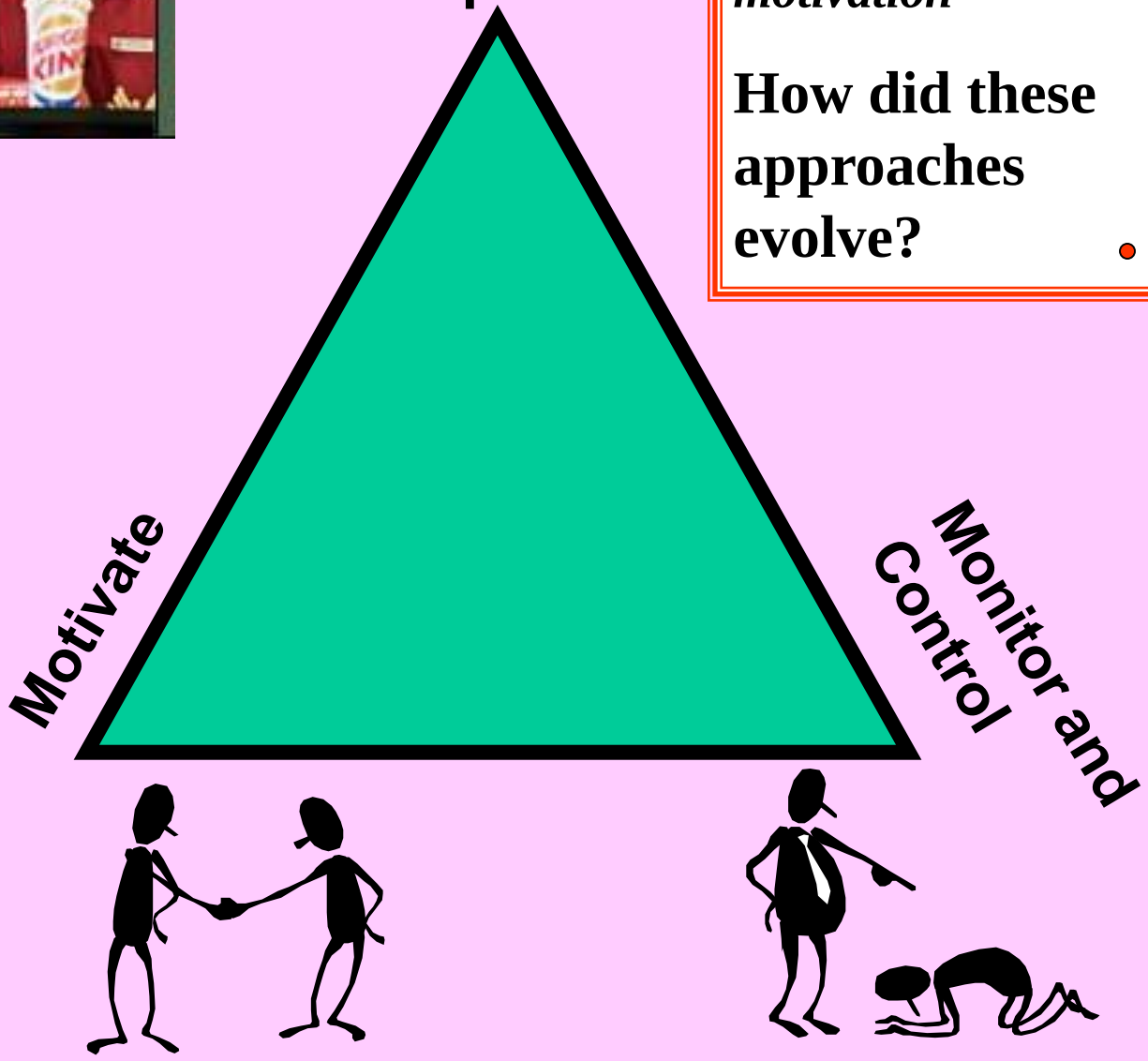




Where did UK Burger King end up?

- ***Pay level and incentive***
- ***Monitor time standards***
- ***Non-cash motivation***

How did these approaches evolve?



Historical Evolution: Pre-New Deal

- **Wage structure**

  Early 20th century development of job design (time & motion), job evaluation, and wage and salary administration through point systems

- **Social welfare benefits**

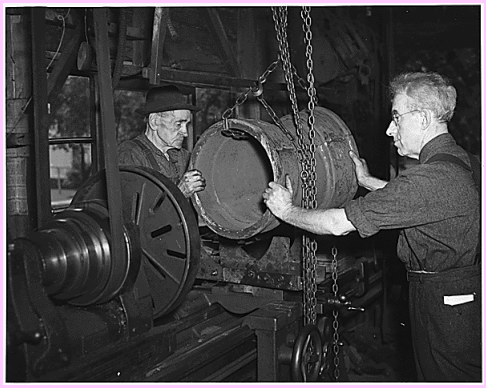
  Encouragement of employee thrift (predecessors to 401ks); some pensions, etc.

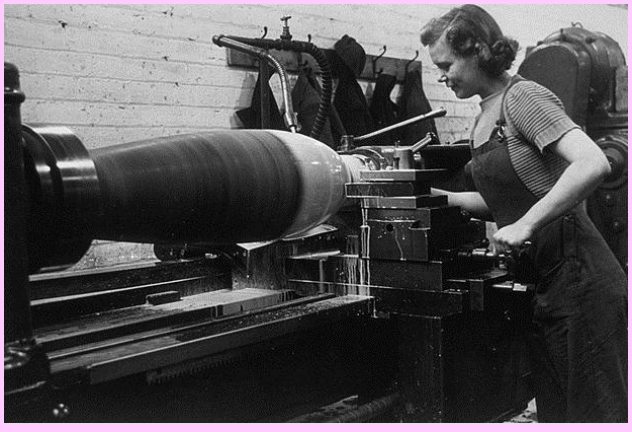
- **Incentives**

  Taylorist piece rates or control & "efficiency wages" (Ford)

World War II

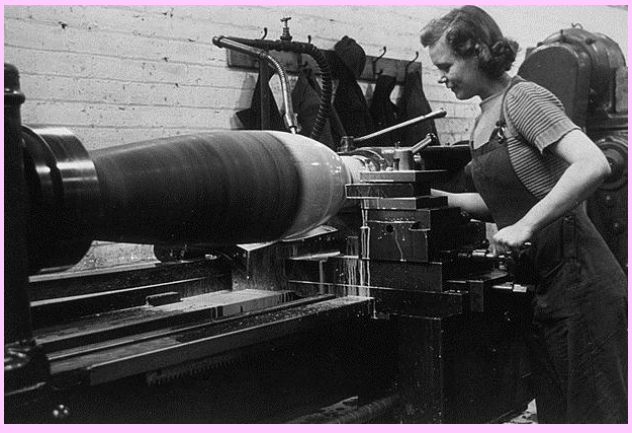
- **Emphasis on maximum wartime production**
- **Interest in use of incentives temporarily boosted by wartime goal**
- **“Human relations” approach begins to catch on**





World War II

- **Old Taylorist idea:**
  - **How do you get the help to do what you want?**
- **New human relations idea:**
  - **How do you get the help to help you do what you want?**



Post-World War II

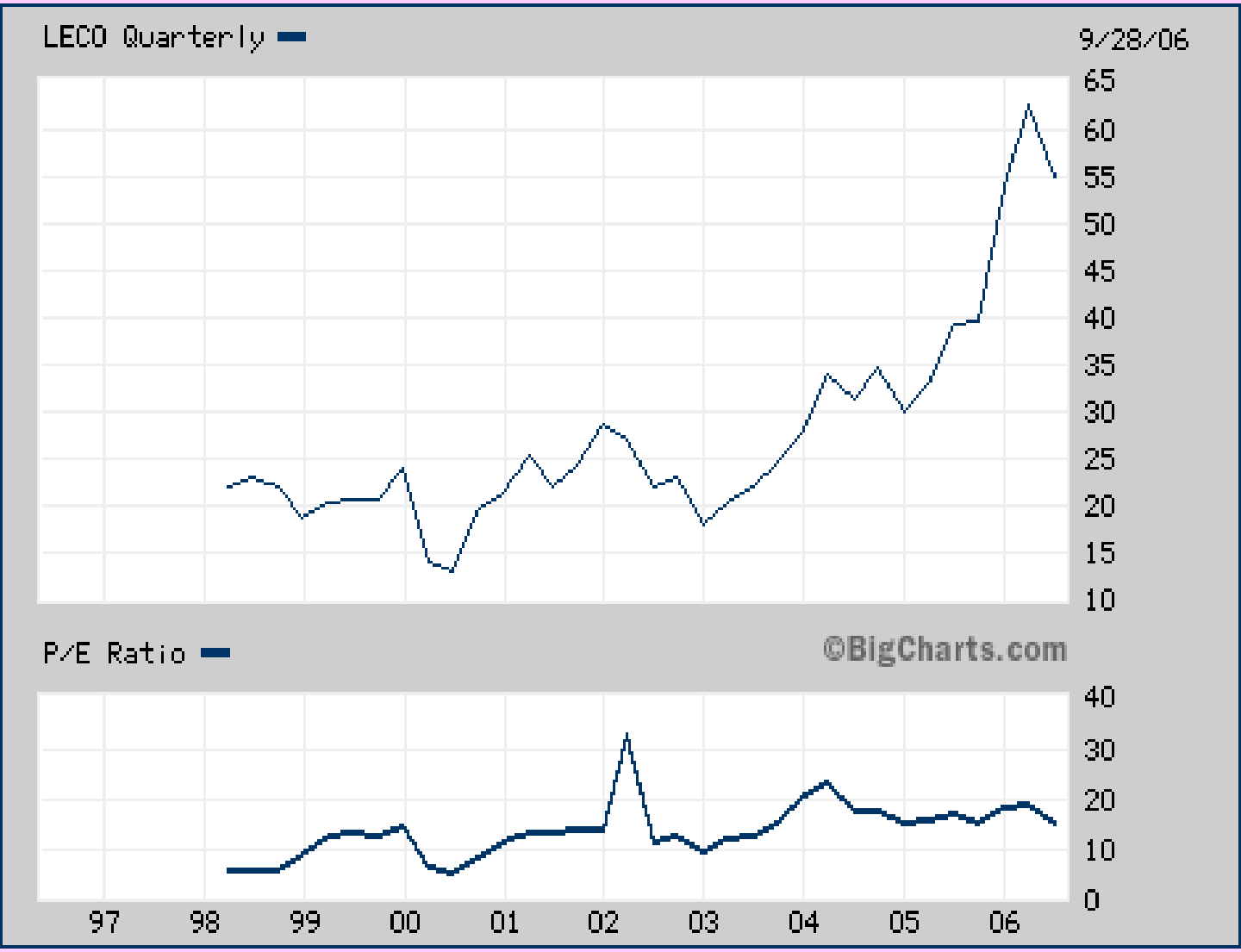
- **Impact of Depression Memories: Desire for Income "Security"**
  - ***Stock ownership: "In some cases it was difficult to explain the situation to certain uneducated elements... who could not comprehend why they were not paid in full." (NICB)***
  - ***Profit sharing also disfavored***
  - ***Unions seek job protections: SUB plans, regulation of layoffs***
  - ***Demands for social welfare benefits***
- **Emphasis on fairness, human relations, in wage setting**

  Wage and salary administration institutionalized

Post-World War II to present

- **Social welfare benefits (1945-80)**
  - ***Greatly expanded offering of pensions, health insurance***
  - ***Union sector an initial center of such benefits; nonunion sector follows***
  - ***Benefits fit with emphasis on security***
  - ***Tend to tie workers to firm***
- **1980s to present: Union decline; pay for performance, erosion of social benefits, reduced job security**
- **Search for a "new" model for 21st century continues**

Lincoln Electric Quarterly Stock Price Average



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